

Report to the Legislature  
Rice Straw Utilization Tax Credit Program  
California Department of Food and Agriculture  
June 1, 1998

The Rice Straw Utilization Tax Credit Program was established by SB 38 (Lockyer, Ch 954, 1996) as Section 17052.10 of the State Revenue and Taxation Code. The law provides that for each taxable year beginning on or after January 1, 1997, and before January 1, 2008, there shall be allowed as a credit against the amount of "net tax," as defined (California state income tax), the amount of \$15 per ton of rice straw that is grown within California and purchased during the taxable year by the taxpayer. The taxpayer must be the "end user" of the rice straw, meaning anyone who uses the rice straw for any purpose, including but not limited to processing, generation of energy, manufacturing, export, or prevention of erosion, exclusive of open burning, that consumes the rice straw. The taxpayer cannot be related, under the Internal Revenue Code to any person who grew the rice straw within California. The law limits the aggregate amount of the tax credit to \$400,000 for each calendar year. In cases where the tax credit exceeds the "net tax," the excess may be carried over to reduce the "net tax" for the next ten taxable years, or until the credit has been exhausted, whichever comes first.

Under the law, the California Department of Food and Agriculture (CDFA) must:

- certify that a taxpayer has purchased rice straw during the specified taxable year,
- issue certificates to qualified taxpayers on a first-come, first-served basis,
- provide an annual listing to the Franchise Tax Board,
- provide the taxpayer with a copy of the certification,
- obtain the taxpayer's identification number, and
- provide an annual informational report to the Legislature.

**Background:**

The Connelly-Areias-Chandler Rice Straw Burning Reduction Act of 1991 (AB 1378, Ch 787, 1991) mandated the phase down of open field rice straw burning by 1998. The phase down period was recently extended until 2000 (Thompson, SB 318, Ch 745, 1996) due in part to the recognition that alternative straw management options were costly and slow to develop. Furthermore, soil incorporation of straw, the only widely available management option, continues to cause adverse effects to rice farming operations including but not limited to increased costs, increased incidence of disease and weeds, and other land and irrigation management problems.

The Legislature, recognizing the need for incentives to speed the development of off-field uses of rice straw, established the tax credit as one incentive. The \$400,000 annual tax credit represents 26,667 tons of rice straw, or about 9,000 to 13,000 acres. Last year, about 485,000 acres of rice was planted in the Sacramento Valley.

**Program Status:**

Last year, 1997, was the first year of the program. Nearly one hundred fifty telephone, written and faxed inquiries were received and responded to by the Department. Applications for the tax credit were accepted on a first-come, first-served basis starting on September 2, 1997 at 8:00 am at the CDFA headquarters in Sacramento. To date 35 applications have been received, requesting \$468,459 in tax credits for purchase of 31,230.6 tons of rice straw. CDFA approved 28 applications totaling \$90,506 in tax credits for purchase of 6,033.7 tons of rice straw. Please see Table 1.

**Table 1: Program Summary**

<b>Requests</b>	<b>Number</b>	<b>Tons</b>	<b>Tax Credit (\$)</b>
Total	35	31,230.6	\$468,459
Certificates Issued	28	6,033.7	\$ 90,506
Denied	7	25,196.9	\$377,953

Of the seven applications denied, four did not adequately document purchase, while three purchased straw in other years, but did not purchase the straw in 1997. Those that documented purchases in 1998 will be able to apply for the tax credit under the program next year, if they so chose. Several of these applications were from companies anticipating start up of new straw processing facilities that did not materialize. As such, they did not exercise their intent to purchase rice straw, and thus did not in fact purchase rice straw. Thus, they did not qualify for the tax credit and their applications were denied. Three of these applications represented 25,000 tons of rice straw.

Of the 27 applications approved, 18 were dairies, four were manufacturing companies, three were other livestock operations, two were private home builders, and one was a landscaping contractor. The primary uses of the rice straw were for animal bedding, animal feed, erosion control, straw bale construction, and compost/fertilizer manufacturing. Please see Table 2 and Table 3.

**Table 2: Types of Businesses**

<b>Business</b>	<b>Number</b>	<b>Tons</b>	<b>Tax Credit (\$)</b>
Dairy	19	3,336.6	\$50,049.00
Cattle	3	939.9	\$14,098.50
Landscape Contractor	1	49	\$ 735.00
Compost/Fertilizer Mfg.	1	1,263.7	\$18,955.50
Feed Manufacturer	1	336.3	\$5,044.50
Erosion Control Mfg.	1	58.5	\$ 877.50
Owner/builder	2	49.7	\$ 745.50
TOTAL	28	6,033.7	\$90,506

**Table 3: Methods of Use**

<b>Method</b>	<b>Number*</b>	<b>Tons*</b>
Animal bedding	18	2966.7
Feed	6	2,501.5
Compost/fertilizer	1	1,263.7
Building construction (bales)	2	49.7
Erosion control	3	460.2
<b>TOTAL</b>	<b>30</b>	<b>7,241.8</b>

\*Two certified applicants used the straw for multiple purposes (feed/bedding, and erosion control/bedding). Thus, 1,208.1 tons of straw is double counted.

The Department has prepared an annual listing of the qualified taxpayers who were issued certificates and the amount of rice straw purchased by each taxpayer and provided it to the Franchise Tax Board on computer readable form and in the manner prescribed by the Board.

The Department will announce the 1998 Rice Straw Utilization Tax Credit Program in August, 1998, before rice harvest begins. The Department anticipates accepting applications for the 1998 tax credit on a first-come, first-served basis in late November or early December, 1998.

### **Conclusions and Recommendations:**

Industry experts and the University of California, Department of Agricultural and Biological Engineering estimate that no more than 40,000 tons of rice straw were harvested in 1997. Most probably, that figure does not exceed 20,000 tons. Thus, about 30% of the harvested rice straw was purchased under the tax credit. Currently the potential for harvesting rice straw is limited by equipment availability and, during this past year, weather.

Although the rice straw utilization tax credit is limited in scope compared to the available resource, it is not yet limited when compared to the current market for the resource or the ability to harvest the resource. There is no existing large market for rice straw that can take full advantage of the tax credit. The dairy industry seems to be in the best position to claim the tax credit. In this situation, the tax credit serves to offset the transportation costs associated with hauling the straw from the Sacramento Valley rice production region to dairies in the San Joaquin Valley. It is anticipated that many more dairy operators will take advantage of the tax credit in the coming years.

A successful startup of a commercial straw processing facility could change the dynamics of the program drastically. Any such facility that processes straw to straw board, fiber board, feed, ethanol fuel, electricity, erosion control materials, pulp or paper, or other products at a commercial scale would easily consume the amount of straw each year that would be eligible for the tax credit. At this point in the development of these projects, project financing and straw handling infrastructure and logistics are more formidable

barriers than the cost of rice straw. This is not to say that rice straw costs, and thus, the incentive provided by the tax credit is not important. An assured reduction in the straw acquisition cost that can be provided by the tax credit, can make some straw processing projects more attractive to potential investors.

As demand for the tax credit increases, and economic and environmental benefits of off-field rice straw utilization are documented, the Legislature may want to consider expanding the program by lifting the annual \$400,000 cap in order to attract larger and more diverse projects.

The CDFA has also received comments concerning the equity of the “first-come, first-served” provision, since conceivably, one entity could use the entire credit. Some have suggested that a cap of \$1,000 to \$4,000 be established for individual applications.

If the tax credit provides little incentive to new, startup processing facilities, the Legislature may want to consider a tax credit purchase or trading program that would allow new straw utilization projects with little or no California income tax liability to sell their tax credits to a profitable entity that could take advantage of the tax credit. The CDFA has received several inquiries and suggestions in this regard.

Several members of the rice industry have suggested that the unused tax credit from each year be dedicated to other activities that support off-field utilization of rice straw. Such activities may include but not be limited to development of rice straw harvest and storage infrastructure, market development and expansion for rice straw based products, and support for those potential utilization technologies not supported through other programs.

Attachments:

1997 Summary Table

Section 17052.10 of the Revenue and Taxation Code

Rice Straw Utilization Tax Credit Program Announcement

1997 Summary  
Rice Straw Utilization Tax Credit Program  
California Department of Food and Agriculture

Type of Business	Use	Tons	\$ Credit \$
Dairy	Animal Bedding	87	\$1,305.00
Dairy	Animal Bedding	19.27	\$289.05
Dairy	Animal Bedding	15.1	226.5
Owner/Builder	Building Construction	4	\$60.00
Cattle	Livestock Feed	9	\$135.00
Dairy	Animal Bedding	199.75	\$2,996.25
Hydroseeding Contractor	Erosion Control	49	\$735.00
Dairy	Animal Bedding	159.11	\$2,386.65
Dairy	Animal Bedding	65.04	\$975.60
Manufacturer	Compost/Fertilizer	1,263.75	\$18,956.25
Dairy	Animal Bedding	159.82	\$2,397.30
Dairy	Animal Bedding	300	\$4,500.00
Dairy	Animal Bedding	181.615	\$2,724.23
Dairy	Animal Bedding Livestock Feed	855.18	\$12,827.70
Manufacturer	Erosion Control Blankets	58.48	\$877.20
Owner/Builder	Building Construction	45.7	\$685.50
Dairy	Animal Bedding	43.34	\$650.10
Dairy	Animal Bedding	43.02	\$645.30
Dairy	Livestock Feed	25.87	\$388.05
Dairy	Animal Bedding Erosion Control	352.74	\$5,291.10
Manufacturer	Livestock Feed	336.285	\$5,044.28
Dairy	Animal Bedding	40.075	\$601.13
Dairy	Animal Bedding	79.28	\$1,189.20
Dairy	Animal Bedding	119.79	\$1,796.85
Dairy	Animal Bedding	200	\$3,000.00
Dairy	Animal Bedding	46.54	\$698.10
Dairy	Livestock Feed	370	\$5,550.00
Cattle	Livestock Feed	905.2	\$13,578.00
<b>TOTAL</b>		<b>6,033.955</b>	<b>\$90,509.34</b>